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**FISCAL IMPACT STATEMENT**

**LS 7050**

**BILL NUMBER:** HB 1250

**NOTE PREPARED:** Jan 29, 2007

**BILL AMENDED:**

**SUBJECT:** Insurance Premium Tax.

**FIRST AUTHOR:** Rep. Fry

**FIRST SPONSOR:**

**BILL STATUS:** As Introduced

**FUNDS AFFECTED:** X GENERAL  
DEDICATED  
FEDERAL

**IMPACT:** State

**Summary of Legislation:** The bill reduces the Insurance Premium Tax from 1.3% to 1% over a three year period.

**Effective Date:** January 1, 2008.

**Explanation of State Expenditures:** The Department of Insurance will incur additional expenses to revise tax forms, instructions, and computer programs to reflect the tax rate changes. The Department's current level of resources should be sufficient to implement these changes.

**Explanation of State Revenues:** The bill reduces the Insurance Premiums Tax rate incrementally from the current 1.3% to 1% in 2010. The rate reduction schedule is specified in the table below.

Calendar Year	Tax Rate
2007	1.3%
2008	1.2%
2009	1.1%
2010 and after	1.0%

It is estimated that the rate reductions would reduce revenue from the Insurance Premiums Tax as specified in the table below, with the revenue loss estimated to grow at about 2% to 4% annually after FY 2010 when

the rate reduction is fully phased-in.

Fiscal Year	Revenue Loss
2008	1.6 M - 1.7 M
2009	5.0 M - 5.1 M
2010	8.4 M - 8.8 M
2011	10.3 M - 10.8 M

*Background:* The Insurance Premiums Tax is imposed on gross premiums received by domestic and foreign insurance companies on policies covering risks in the state minus deductions for reinsurance premiums, dividends paid to insured residents, and premiums returned. Domestic insurance companies may elect to pay the Adjusted Gross Income (AGI) Tax in lieu of the Insurance Premiums Tax. The Insurance Premiums Tax rate is 1.3%. However, under the retaliatory tax scheme, a foreign insurance company must pay the greater of 1.3% or the insurance tax rate imposed in the state in which the foreign insurance company is domiciled.

Revenue from the Insurance Premiums Tax is distributed to the state General Fund. Insurance Premiums Tax revenue totaled \$174.1 M in FY 2006. Revenue from the tax has grown at an average annual rate of about 2.7% since FY 1996.

The fiscal impact of the tax rate reductions is simulated utilizing annual life, accident and health, and property and casualty premiums data reported on the basis of the state of domicile of the insurance companies writing the premiums. Premiums reported in 2005 and recent growth rates in reported premiums are used to estimate premium totals for the 2008-2011 period. Current insurance tax rates for all states are utilized to derive estimates of premium tax revenue (including the revenue generated under retaliatory tax scheme) under the current and proposed tax rate regimes.

Because of the retaliatory tax feature of the Insurance Premiums Tax, the estimated revenue loss due to the proposed rate reductions is attributable to: (1) domestic insurance companies that pay the Insurance Premiums Tax (and have not elected to pay the AGI Tax); and (2) foreign insurance companies domiciled in states that have insurance tax rates less than 1.3%. Currently, most domestic insurance companies elect to pay the AGI Tax in lieu of the Insurance Premiums Tax. In addition, only six states have insurance tax rates below 1.3%. As a result, the percentage revenue loss from the tax rate reductions will be much less than the percentage reduction in the Insurance Premium Tax rate under the bill.

Recent collection data indicates that most domestic insurance companies are electing to pay the AGI Tax in lieu of the Insurance Premiums Tax. Consequently, only about 6% to 7% of the projected revenue loss is attributable to domestic insurance companies. It is important to note that the extent to which the rate reductions will cause domestic insurance companies to discontinue paying the AGI Tax and begin paying the Insurance Premiums Tax is unknown. While this may lead to increases in revenue from the Insurance Premiums Tax, it would lead to an offsetting decrease in AGI Tax revenue. It is assumed that these movements would result in a net revenue loss to the state, as companies would only move from the AGI Tax to the Insurance Premiums Tax if it reduced their overall tax liability.

As to the impact from foreign insurance companies, only six states impose insurance tax rates that are less

than 1.3%. Thus, the tax rates that currently apply to most foreign insurance companies will not change because of the retaliatory tax scheme. The preponderance of the estimated revenue loss (70% to 72% of the total) is attributable to Illinois domiciled insurance companies, because Illinois insurance tax rates are currently set at 0.5% (0.4% for accident and health insurance premiums) and because Illinois domiciled insurance companies annually account for over \$2,000.0 M in premiums written in Indiana.

**Explanation of Local Expenditures:**

**Explanation of Local Revenues:**

**State Agencies Affected:** Department of Insurance; Department of State Revenue.

**Local Agencies Affected:**

**Information Sources:** Department of Insurance premium and tax rate data, 1998-2005. Indiana Legislative Services Agency, *Indiana Handbook of Taxes, Revenues, and Appropriations, FY 2006*. Cindy Donovan, Department of Insurance, (317) 232-2408.

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